

**EXHIBIT**

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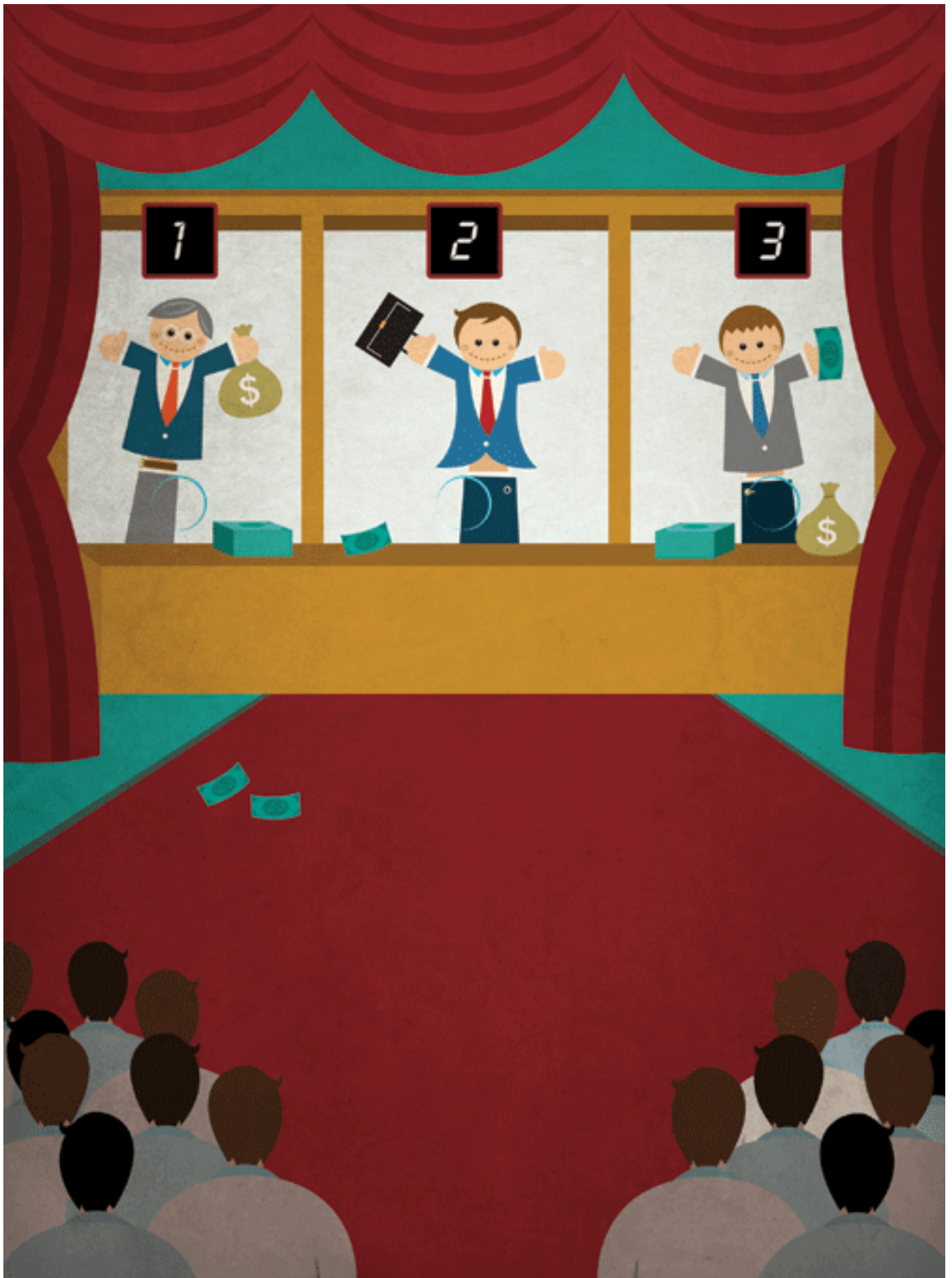
# Who owns the banks

## Revealing the hands holding the real power in Lebanon

FINANCE

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Lebanon's banking sector has been called many things: the unofficial government, the country's financial savior, a nepotistic mafia, and that 'other economy,' which continuously shines while the 'real economy' limps behind.

That the banks have extraordinary influence here is a given, having funded the country's post-war reconstruction through loans to the government and ridden out every kind of systematic risk imaginable, bar a nuclear bomb or natural disaster. The banks and the bankers are Lebanon's economic superstars.

### The 'real' power brokers

The owners of the banks are clearly powerful men, with the ear of the government and the Central Bank. Indeed, BankMed is owned by the Hariri family's Group Med, with Prime Minister Saad Hariri having a 24 percent stake. Central Bank Governor Riad Salameh was appointed during the late former Prime Minister Rafiq Hariri's first term in office in 1993, while many of the senior administration are affiliated with the Hariri political camp. More than one private sector figure has told *Executive* over the years off the record: "We are the government."

"Definitely bankers are more powerful than the political system," said Badri el-Meouchi, executive director of the Lebanese Transparency Association (LTA). "The Association of Banks in Lebanon has more weight with politicians than any other organization in the country, and banking regulations were drawn up by the banks decades ago and have been protected since then."

With Lebanon's 62 banks predominantly managed by founding families — although they are not always the major shareholders — the sector is controlled by a small cabal. It is also largely dominated by the country's 12 alpha banks — those with deposits over \$2 billion.

At the end of 2008 alpha banks held \$95 billion in consolidated assets, or 88.3 percent of all banks' consolidated assets, and \$77.3 billion in customer deposits (83.7 percent of total deposits), according to Bilanbanque, the annual report issued by the financial services firm BankData in collaboration with the Association of Banks in Lebanon, which had yet to publish 2009 figures as *Executive* went to print.

Governments and financial sectors are intertwined across the planet, but in Lebanon, where the banks control the lion's share of the country's debt and are such major contributors to gross domestic product (see story on page 86), how they are owned and managed is an issue of paramount concern.

"There is clear political influence," said Ali Awdeh, head of the research department at the Union of Arab Banks. "They are the country, but not in a 'negative' way; they are the economy. But the government wouldn't want to make them angry... so maybe the bankers are more powerful than politicians."

But the connections between the government and the banking sector are opaque, in terms of financing of political parties and bankers' influence over economic decision making on the national level.

Politics aside, there is also not full disclosure of banks' financial practices and agreements with shareholders.

"The major problem we face is transparency, which is not as it should be. That's why there is not 100 percent disclosure and no one knows what bonuses are," said Awdeh.

"Transparency on banks' investments is needed to assess risk exposure of banks. For instance, 'marketable securities' could be anything, from biscuits to tobacco," he added.

### The importance of being open

The Alpha banks are, in general, more transparent than the Beta banks due to listing on the Beirut Stock Exchange (BSE), wanting to list on bourses abroad and needing to attract capital through financial institutions acquiring shares. This has led to a gradual implementation of corporate governance at the Alpha banks as institutions demand greater disclosure.

“To be listed on stock markets outside Lebanon the criteria is stronger than on the BSE, which is not strong on corporate governance,” said Meouchi. Currently just six banks have listed shares on the BSE. This is not enough, according to Awdeh, “because if shares are listed we know who owns the banks, as they have to disclose information. But maybe [most] banks are avoiding being listed to not have to declare more information.”

While banks do list major shareholders, the connection between companies, particularly holding companies, and the management is not always clear. Many of these holding companies have little or no publicly available information, and in certain cases, holding companies are wholly or part-owned by banks’ founding families and other shareholders.

“The moment you start looking in an objective way at the books of the banks, you are opening Pandora’s box. And auditors are named by banks not by the government, so there is a problem in Lebanese commercial law,” said Yahya Hakim, managing director of the LTA.

Government oversight of the legally mandated external audits at commercial banks is through “Lebanese Certified Public Accountants.” Often, however, the partner at the auditing firm and the “public accountant” signing off on the audit are the same person.

“The key is corporate governance and governing structures that are in place. This is a global phenomenon, not just in Lebanon, but also in Europe and the United States. What we want to see is accountability, transparency, committee structure and lines of responsibility,” said Thomas Jacobs, senior country officer Lebanon at the International Finance Corporation (IFC), the private arm of the World Bank Group.

Earlier this year, the IFC acquired an 8 percent stake in Byblos Bank for \$100 million.

“If banks really want to grow and be major players, they need other investors. Look at Byblos, it wanted IFC, and Bank Audi had [Egyptian investment bank] EFG-Hermes,” he added.

### **Opening the Alphas**

Among the Alpha banks, the major shareholders are no longer Lebanese banking families. They are institutional investors, private investors, holding companies and Gulf royalty.

The banking families still make up the management and sit on their boards of directors, but as a percentage few have controlling stakes.

“If you compare the ownership structure of the top three or four banks with the beta banks, it is institutional shareholders versus families,” said Jacobs.

Take BLOM Bank, for instance, established by Syria’s Azhari family. The family has a 2.86 percent direct stake, plus an 11.87 percent stake through the Azhari’s Banorabe Holding in Luxembourg, while AZA Holding — of which the family controls 50 percent — has a 9.33 percent stake in BLOM. Cumulatively it is not enough for the Azharis to have control.

As Saad Azhari, managing director of BLOM, told Executive: "If we didn't perform as management, the shareholders could make us go."

BLOM Bank's largest shareholder is the Bank of New York Mellon, with 34.37 percent.

Bank Audi-Saradar and Byblos are similar. The Audi family has an 8.07 percent stake and the Saradars hold 6.84 percent. Prominent investors include the Kuwaiti royal family, al-Sabbah, with 4.90 percent and Sheikha Suad al-Homaizi with 8.08 percent, the UAE's Sheikh Diab bin Zayed al-Nahyan with a 6.72 percent stake, and prominent Saudi family al-Hobayb with 5.25 percent. The Gulf connection is not surprising, given that Raymond Audi established the bank in 1962 with his brothers and prominent Kuwaiti businessmen. Kuwaiti Sheikha Suad al-Homaizi has been on the board of directors ever since.

Byblos Bank's founding family, the Bassils, have a 3.57 percent stake, but like the other Alpha banks the family manages Lebanon's third largest banking institution. Byblos and BLOM have common shareholders, with the Bank of New York Mellon having a 12.12 percent in Byblos, while BLOMINVEST Bank, BLOM Bank's investment arm, also has a 1.56 percent stake in the bank.

There is a great deal of this cross-linkage in the sector. Major French financial player Group Credit Agricole has a 9 percent stake in Banque Libano-Francais and a 6 percent stake in Fransabank. The latter is dominated by the Kassar family, with Adnan Wafic Kassar, chairman and general manager (and minister of state in the cabinet), and General Manager Adel Kassar holding 36.15 percent each. Fransabank also has a 74.04 percent stake in BLC Bank and 40 percent of BBAC through recent acquisitions, making the Fransabank Group one of the biggest players in the sector.

### **A family affair**

While the diversification of the shareholder structure has had a positive impact on the industry in terms of growth and accessing capital, concerns still need to be addressed.

"The issue of conflict of interest is not very strong [in corporate governance here] as shareholders are a closely linked group," said Meouchi. "Then there are minority shareholders rights, which are not a focus. If banks want to attract more shareholders they have to give them protection, which is something new."

Major shareholders invariably have seats on banks' board of directors while, as mentioned, the founding families dominate management.

"The shareholder base is a little wider now but family control is still there, and you can't tell what agreements exist between shareholders, who most of the time are silent shareholders," said Hakim.

On the other hand, the bankers justify the family-owned structure, pointing to the sector's weathering of the global financial crisis and the spike in deposits that followed, particularly from the Gulf, that have made the banks record profits and heavily liquid.

### **Best to keep it close**



"There is a study which showed that over the long-term, family businesses do better than public companies and the reason is that today when you are on the financial markets, managers tend to look at short term profits because every three months you have to show your figures and make them better than expectations," said Walid Raphael, GM of Banque Libano-Francaise.

"When a bank is controlled by a family usually they look at the long-term and they try to put a strategy to achieve long-term goals. I think it has played a certain role in our resilience over the last international financial crisis because bankers were more conservative in their approach to risky assets and in their policy of managing the bank," he added.

### **Investment's double-edged sword**

Shareholders have been both a boon and a risk to banks that have opened up to external investors. For instance, in 2006 EFG-Hermes acquired a 20 percent stake in Bank Audi, later increasing this to 28 percent. When the Egyptian investment bank went in, it sunk more than half its equity to effectively be a passive investor.

"It didn't make any sense, but to make it convincing they came up with a stock option plan to give six million shares to the staff of Bank Audi, but only three or four of the staff got the bulk of it... equivalent to some \$200 million," said a bank's general manager, requesting anonymity.

"It was a very short term management thing, then EFG started buying extra shares, speaking with other shareholders and wanted control of the bank. At the end they were buying shares without really declaring them and there was a big fight among the board, as the largest shareholder in the bank was not in agreement with the management."

Audi's Chief Financial Officer Freddie Baz disagreed, saying EFG-Hermes left as "happy investors." The Egyptian investment bank sold its stake in January for \$913 million after giving up the possibility of acquiring a bigger stake and rumors of a merger were quashed. Half of the stake was sold to a group of existing shareholders and other individuals, while \$450 million in shares was acquired by M1 Group, the Lebanese holding company headed by former prime minister and billionaire Najib Mikati.

### **Confidence injection**

A more positive development has been the IFC's investment in Byblos Bank, as well as its extension of \$482 million in guarantees to four Lebanese banks since 2006 as part of its Global Trade Finance Program.

"The IFC has added a lot of confidence to these banks and it is not hot money, this is stable money," said Awdeh. The IFC's Jacobs said that while they are fairly exposed due to their involvement in the Lebanese banking sector, the corporation might invest in "one or two more banks."

Meanwhile, in late May, American emerging market fund Franklin Templeton Asset Management indicated an interest in investing in Lebanon's banking sector, after its executive chairman came to Lebanon on invitation of BLOMINVEST.

“Banks are well run, Lebanon is doing well, and banks are growing regionally. To me, that points to good investment opportunities,” said Jacobs.

How further foreign institutional shareholders investing in the banks will impact the sector remains to be seen. This could lead to heightened demand for transparency, minority shareholders rights and corporate governance — or investors will accept the current modus operandi of the banks’ management.

But for now, it is very much business as usual in Lebanon’s centers of economic power.

As Awdeh said, “the banks have started to escape the mentality of being a family business, but it will take a lot of time.”

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